No. 12,881

IN THE

United States Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

APPELLANT'S OPENING BRIEF.

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JURISDICTIONAL STATEMENT.

This is an appeal from a decision of The Tax Court of the United States in which a deficiency in income taxes was determined against the Appellant Bank for the year 1943. The findings of fact and opinion below are reported in 15 T.C. 544 (Adv. No. 74), and are set forth in full in the record herein. (R. 119.)

Appellant Bank is a national banking association which was incorporated on March 1, 1927 under the laws of the United States, and maintains its principal office in San Francisco, California. (R. 7, 23.) Appellant filed its 1943 income tax returns with the Collector of Internal Revenue for the First District of California at San Francisco, California. (R. 8, 23.)

Appellee, the Commissioner of Internal Revenue, determined a deficiency in said Bank's income taxes for the year 1943 and on June 5, 1945, pursuant to Section 272 of the Internal Revenue Code, sent to the said Bank a notice of said deficiency. (R. 8, 23.) The said Bank filed its appeal to The Tax Court of the United States pursuant to Section 272 of the Internal Revenue Code and thereafter duly filed an Amended Petition with said Court. (R. 3.) The said Commissioner of Internal Revenue duly filed his Answer to said Petitions. (R. 3.) The appeal was heard on November 7, 1949, and the case was submitted upon the introduction of a Stipulation of Facts and documentary evidence. On October 20, 1950, The Tax Court promulgated its findings of facts and Opinion (R. 5, 119), and on December 22, 1950, the decision of The Tax Court determining a deficiency in tax against said Bank was entered. (R. 5, 143.)

On February 9, 1951, under authority of Sections 1141 and 1142 of the Internal Revenue Code (Title 26 U. S. Code, Sections 1141 and 1142), the Appellant Bank filed its petition for review by this Court of said decision of The Tax Court of the United States. (R. 145.) This appeal and the transcript of record herein were duly filed and docketed in this Court on March 19, 1951. (R. 155.)

STATEMENT OF THE CASE.

The controversy herein involves the correct income tax liability of the Appellant Bank for the year 1943, which in turn involves the question of whether a loss

resulting from the sales of certain parcels of real estate in that year is deductible from gross income for income tax purposes. The Tax Court concluded that the sales were not *bona fide* sales with a complete termination of the Bank's interest in the properties so the loss was not allowable. In view of The Tax Court's conclusion, the issue is narrowed to the question of whether the sales of the properties by the Bank were *bona fide* sales recognizable as such for tax purposes.

The facts were stipulated and will be analyzed hereinafter in detail, but for purposes of this Statement the following summary will present a fair introduction to the case.

Prior to 1943 the United States Comptroller of the Currency had made a demand upon the Bank to reduce its surplus accounts by a write-down of certain parcels of its real estate, in which were located branch banks, from the value at which they were carried on the books of the Bank to their current market value. The Bank challenged the Comptroller's authority to compel such a write-down and also questioned the Comptroller's current market appraisal of the property. The Bank contended it had the legal right to carry the property at cost less reasonable depreciation.

In a settlement of the dispute, the Bank agreed that it would effect a charge-off or write-down of certain properties to an agreed market valuation provided it were permitted to do so in a manner consistent with its contentions. The Comptroller had no objection to this, so the Bank sold these parcels of property to

Capital Company for cash at the appraised valuations. Capital Company then leased the properties to the Bank upon a rental basis yielding 6% per annum return to Capital Company on the price it paid for the property. This rental was reported by Capital Company as income, and by the Bank as expense, for income tax purposes. Capital Company is a substantial real estate company all of whose stock is owned by Transamerica Corporation, a holding company, who in 1943 with its subsidiaries owned about 25% of the outstanding capital stock of the Bank.

When this transfer of property was made to Capital Company, Capital Company agreed with the Bank that if the Bank wanted to repurchase the properties, Capital Company would sell the properties back to the Bank for the same price plus acquisition costs, which it had paid. The parties *deliberately* refrained from putting this agreement in writing.

Thirty days or so after the transfer of the property from the Bank to Capital Company, Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased the property from Capital Company for cash at the same price, plus acquisition costs, which Capital Company had paid for the properties.

The Bank claimed the difference between its cost of the property and the price which it had received from Capital Company as a deductible loss on its income tax return for 1943, submitting with the return an explanation of the transaction out of which the loss arose. Upon audit of the return the Commissioner

of Internal Revenue disallowed the loss and The Tax Court sustained the Commissioner.

The Tax Court held that the sale to Capital Company was not a *bona fide* sale, that "Capital was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants" and "Capital was obligated to deliver deeds—back to petitioner or Merchants, and the parties never intended, under any circumstances, that Capital should retain title to any of the eight properties," (R. 138) so "the sale must be viewed as being made between petitioner as vendor and Merchants as vendee." (R. 139.) Consequently, The Tax Court ruled that there could be no recognizable loss on the transfer of the properties to Capital Company. As to the transfer of the properties to Merchants, The Tax Court concluded that no loss could be recognized because, "There is no substance to the sale of the branch banks by petitioner to its wholly owned subsidiary" and "Petitioner had complete domination and control over Merchants, and the properties in the hands of Merchants were as much subject to petitioner's control as they were while legal title was in petitioner's own name." (R. 142-143.)

The Appellant Bank contends that The Tax Court erred in its conclusions, that the sales were *bona fide* and were intended to be *bona fide,* and that the loss resulting from the sales is properly deductible under the Internal Revenue Code. The Appellant Bank believes the sale to Capital Company must be recognized as a *bona fide* sale and that the loss resulting there-

from is deductible from gross income; but even if the transaction is construed as a sale from the Bank to Merchants, the mere fact that the Bank has domination and control over its wholly-owned subsidiary, is not valid justification for the disallowance of the loss resulting from the sale.

STATUTE INVOLVED.

Internal Revenue Code:

Section 23(f) Losses By Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Section 111(a) Determination of Amount of, and Recognition of Gain or Loss.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange the extent to which the gain or loss determined under this section shall be recognized

for the purposes of this chapter, shall be determined under the provisions of section 112.

Section 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(None of the exceptions contained in Section 112 are applicable.)

There is no dispute as to the adjusted basis under Section 113 of the property sold by Appellant Bank, nor is there any dispute that the loss if deductible is a loss from the sale of assets other than capital assets under Section 117(j), so there is no need to transcribe any provisions of the Internal Revenue Code other than those quoted above.

ASSIGNMENTS OF ERROR.

The following are the assignments of error as set forth in the Petition for Review (R. 149-150):

In making and rendering its decision as aforesaid, The Tax Court of the United States erred to the prejudice of petitioner in the following respects:

1. In determining a deficiency in income and excess profit taxes for the calendar year 1943 and in failing to find that the petitioner overpaid its tax for said year.

2. In determining that the sale by petitioner of certain parcels of real estate to Capital Company

lacked substance and reality and was not a bona fide sale.

3. In determining that the loss sustained by the petitioner in the sale of said parcels of real estate to Capital Company was not deductible for tax purposes.

4. In determining that the sale by the petitioner of said real estate to Capital Company and the later sale of said real estate by Capital Company to Merchants National Realty Corporation, a wholly-owned subsidiary of the petitioner, was not a transaction recognizable under the income tax laws to the extent that losses which were sustained therein could be allowed as deductions for tax purposes.

SUMMARY OF ARGUMENT.

The Appellant argues that The Tax Court was wrong in concluding (1) that the sale from the Bank to Capital Company was not *bona fide,* (2) that Capital Company was a mere conduit for transfer of title to Merchants and that the Bank never relinquished dominion and control of the property which it sold, (3) that the transaction was in reality a sale of property by the Bank to Merchants, (4) that no loss was sustained or could be recognized for tax purposes on the sale to Capital Company, (5) that the Bank's dominion and control was sufficient to justify a disregard of any tax consequences on transactions between the Bank and Merchants, and (6) assuming the transaction to be a sale by the Bank to Merchants,

that no loss was sustained or could be recognized for tax purposes on the sale to Merchants.

In general, the Appellant predicates its argument upon two factors:

(1) That the parties intended the sale to Capital Company to be a *bona fide,* closed and completed transaction, separate and distinct from any later resale of the property by Capital Company, and

(2) That the transactions involved in this case were not intended or executed for the purpose of, or as a means of, tax avoidance.

The argument will show that the test of deductibility of losses sustained upon the sale of property depends upon the intention of the parties to the sale as to whether the sale was to be a real *bona fide* sale. If the sole purpose of the transaction or series of transactions from which the loss alleged to have been sustained is to create a tax loss and avoid a tax, the sale transaction or other transactions by which this is accomplished are considered to be merely pretended sales or transactions and therefore unrealistic or a sham. The cases reach this conclusion by implying the tax avoidance purpose as the sole intent of the entire transactions. In other words, the Courts say that whatever the mechanics employed, the intent throughout was that these mechanics were to be in substance merely a means for accomplishing a tax avoidance regardless of their form and so the intention was not to complete a transaction which might be indicated by the form employed, but merely to secure or accomplish a tax avoidance. The Courts say

that without the intent to take the consequences of a *bona fide* transaction according to its form, such a transaction cannot be recognized for tax purposes. This philosophy and principle of construction of transactions for tax purposes applies similarly in cases where there is a sale and an agreement to repurchase where throughout the entire transaction the only intent was to ultimately accomplish a tax avoidance.

If the tax avoidance scheme is absent, a transaction must necessarily be given its effect according to its form because whatever the purpose might be, the intent must necessarily have been that the transaction in form should be effected to reach the intended objective. Where the tax avoidance scheme is absent, the Courts will recognize intent and purpose as separate and distinct factors and in such instances the purpose will not be applied to vitiate the intent with respect to the transactions employed to reach the desired purpose. *There is no case* where a sale was made for a purpose other than to accomplish a tax avoidance in which it was held that the sale was to be disregarded, even though there might have been a subsequent transaction no matter how close in point of time to the original sale transaction.

In this case the purpose of tax avoidance was absent. The sale by the Bank to Capital Company was made for the sole and exclusive purpose of settling a controversy with the Comptroller of the Currency in a manner which the Bank considered important to avoid establishing any precedent which might later be detrimental to it. The settlement of the controversy

in the manner described was the purpose of the transaction; the intent of the Bank and Capital Company was that the sale should be a closed and completed transaction and that at least for a period of time the sale should be so effective as to divest the Bank of all title and control of the property and to vest that complete title and control in Capital Company as the owner of the property; the intent had to comprehend such a result because it was only by such a transaction having such consequences that the Bank could accomplish its purpose, and be able to support its position that it did not make a mere paper transaction or write-down of assets but actually suffered a loss through a sale of property; the purpose of the arrangement with respect to the possible repurchase of the property was to have an understanding with Capital Company that the Bank could repurchase the property when and if it desired to do so, but the intent behind this repurchase understanding was that it should have no effect upon the original sales transaction and that it should have no legal or binding effect as an encumbrance on Capital Company's ownership of the property because again the ultimate purpose of avoiding precedent which might be detrimental to the Bank in the future required that there be no transaction which might alter the legal effect of the original sale.

The statute (Section 112) requires nothing more than that the cost shall exceed the selling price in order that there be a determination of loss from the sale of property. The question of intent, of realism,

arises from principles established by case authority in applying the statute, and these principles were devised to prevent the deduction of losses from unrealistic transactions made solely for the purpose of defeating the revenue. It is respectfully submitted that in this case there was a sale from the Bank to Capital Company and the selling price was less than the cost of the property sold so that a loss was sustained by the Bank when the sale was made. The element of tax avoidance is not present so there is nothing to bring into play the principles devised to prevent tax avoidance.

In this case there was a later sale by Capital Company to Merchants, but before that sale was made, Capital Company was the owner of the property, in complete control of title and income, which income was included by it in its income tax returns and subjected to tax; and Capital Company was bound by nothing more substantial than a moral commitment made with the Bank to resell the property to the Bank at its request, which commitment was made with the deliberate understanding that it was to be merely a moral commitment and not a legal and binding obligation, and so again the agreement for resale was not such a reserved power as to have the legal effect of vitiating the original sales transaction and the legal consequences thereof, nor did it have the effect of vitiating Capital Company's ownership of the property from the time it purchased until the time it sold. The very intent of the parties was that the repurchase arrangement should not have any effect upon the

original sales transaction. There is no basis whatever under the foregoing analysis of the principles pronounced in the cases on the subject, for disregarding the sale from the Bank to Capital Company and the consequences of such sale under the tax statutes. The loss was sustained. There is no restriction against its allowance as a deduction under the statute so it should be allowed.

The Tax Court's disregard of the sale to Capital Company and its consequent construction of the transaction as a sale from the Bank to Merchants is in direct contravention of the intent and purpose of the Bank, as hereinbefore stated, and in absolute conflict with the facts which show that the Bank deliberately refrained from selling to Merchants. The Court cannot impose upon a taxpayer a transaction which it did not make.

It is the Appellant's view that the sale of its property to Capital Company must be recognized and that the loss sustained upon that sale must be allowed. Under this view of its case, the later sale by Capital Company to Merchants is of no consequence in a determination of the issue involved herein. However, since The Tax Court took the position that the sale should be construed as a sale from the Bank to Merchants, it is necessary to submit some discussion of the case on that premise since the Appellant believes that even on that premise The Tax Court erred in refusing to allow a deduction for the loss sustained in the sale.

If the sale is to be treated as a sale by the Bank to Merchants, the sale has to be recognized as a completed

transaction and the loss resulting therefrom must be allowed as a deduction. Mere domination and control through stock ownership or other arrangement, other than possibly a strict and irrefutable agency arrangement which does not exist in this case, is not sufficient in the absence of any scheme for tax avoidance, to justify a disregard of a transaction between a parent and its subsidiary or the tax consequences thereof. The lease arrangement between the Bank and Merchants, existing since 1936 was not any more unusual than arrangements discussed by the Courts in cases in which it was held that such arrangements would not justify a disregard of the corporate entities or transactions between them. There is no statutory provision or legal authority which would support the refusal to allow as a deduction a loss sustained by the Bank on a sale of property to Merchants.

ARGUMENT.

I. INTRODUCTORY STATEMENT.

The relationship between the parties to the sales transactions involved in the proceeding is of primary importance in the determination of whether The Tax Court is right or wrong in its decision, so the following explanation is given to identify these parties and their participation in the sales transaction.

Bank of America N.T. & S.A.

This Bank is the Appellant, the taxpayer who made the sale of eight properties in 1943 from which a loss resulted, and it is the deductibility of this loss which is involved in this proceeding.

The Bank operates a banking system in California through approximately 500 branches. (R. 121.) Title to some of the buildings in which it conducts its banking business is held by it, and title to others is held by Merchants National Realty Corporation. (R. 121.) The properties owned by Merchants are leased to the Bank. (R. 122, 38, 72.) The eight properties which the Bank sold to Capital Company were properties in which the Bank was operating branches. (R. 34, 37.) After the sale the Bank leased these properties from Capital Company. (R. 38.) Later, Capital Company sold the properties to Merchants National Realty Corporation, after which time the Bank leased the properties from Merchants. (R. 34-35, 38.)

Merchants National Realty Corporation.

Merchants was a wholly owned subsidiary of the Bank. (R. 38.) Many of the officers and directors of the Bank were officers and directors of Merchants. (R. 38.) Merchants had no salaried employees. (R. 38.) Whatever work was necessary to the operation of its business was performed by employees of the Bank. (R. 38.) The only business of Merchants was the ownership of property which it leased to the Bank, under a lease arrangement, which has been in effect since 1936, whereby the Bank paid a rental to Merchants equal to the net expenses and charges of Merchants allowable as deductions from gross income for income tax purposes. (R. 38, 72.) During 1943, Merchants incurred and paid expenses of over $380,000.00. (Ex. 22-V, R. 110) and at December 31, 1943, it had

assets of over $19,200,000.00 and a net worth of over $18,900,000.00, as disclosed by its balance sheet as of that date. (Ex. 22-V, R. 111.)

About 30 days or so after the Bank sold the eight parcels of property to Capital Company as hereinbefore mentioned, Merchants purchased the properties from Capital Company for cash at the same price that Capital Company had paid for them, plus acquisition costs. After Merchants purchased the properties they were leased to the Bank under the general lease arrangement described in the preceding paragraph hereof.

Capital Company.

Capital Company is a substantial real estate company with a net worth of approximately $33,250,000.00 and total assets represented mostly by real estate, of $37,100,000.00. (R. 35, Ex. 18-R, pp. 8, 20-21.) It is a wholly owned subsidiary of Transamerica Corporation. (R. 39.) Transamerica Corporation with its subsidiaries owned about 22% of the outstanding capital stock of the Bank in 1943. (R. 40.) In 1943 Capital Company purchased the said eight properties from the Bank for cash at a price equal to the appraised value of the properties. (R. 35, 36.)

After acquiring the properties, Capital Company leased them back to the Bank under a written lease agreement covering each property and providing in general for a rental payment to yield 6% net to Capital Company on its investment in the property. (R. 36, 38.)

After Capital Company had held the properties for about 30 days it sold them to Merchants for cash for an amount equal to the cost of the properties to it. (R. 36.)

II. NEITHER THE FACTS NOR THE LAW JUSTIFY THE TAX COURT'S CONCLUSION THAT THE SALES TO CAPITAL COMPANY WERE NOT BONA FIDE.

The Tax Court refused to recognize the sale from the petitioner Bank to Capital Company as a *bona fide sale* even though the Court found that, "The facts show that petitioner conveyed the legal title to the properties to Capital Company, and that it meticulously complied with all of the customary formalities necessary for the transfer of title." (R. 134.) The Court based its decision that the sale to Capital Company could not be recognized for tax purposes on the conclusion that, "Petitioner never relinquished dominion or control over the eight properties to Capital. Petitioner intended only a temporary vesting of title in Capital, and it was assured of its ability to recover the properties under its oral agreement with Capital." (R. 137.)

It is true that petitioner "intended only a temporary vesting of title in Capital", but it is indisputable that the petitioner also intended that while Capital owned the property it was to have complete and unencumbered ownership free of any dominion or control of the petitioner. The oral understanding between the Bank and Capital Company that the Bank intended to repurchase the property at some later date and

that Capital Company would resell the property to the Bank upon its request was reached with the further specific understanding that it was not to be in writing (R. 36), which was a deliberate acknowledgment by the parties that the Bank's expression of intent was not to be regarded as a legally enforceable obligation either upon the part of the Bank or upon the part of Capital Company.

The very essence, purpose and objective of the transaction was to take the properties out of the dominion and control of the Bank, actually and legally, for at least a limited period. It was only by such a transaction that the Bank in its opinion, could meet the Comptroller's requirement that there be a charge-off, and at the same time be in a position (1) to maintain that the charge-off represented a loss from a sale and not a mere write-down, and (2) to maintain at any future time that the Bank never receded by word or deed from its position that the Comptroller had no authority to require a write-down of its cost of banking premises other than for normal depreciation.

The Court may have a right to refuse to give effect for tax purposes to a valid transaction where the sole purpose of the transaction was to avoid taxes, or where the transaction was a sham because of the intent to avoid taxes, but there is absolutely no authority which permits the Court to disregard a valid and completed transaction, or to declare it lacking in bona fides, *where it was effected to accomplish a purpose which had no relationship to tax results.* In this connection, the stipulation of facts filed in this proceed-

ing requires careful analysis. As The Tax Court stated in its opinion (R. 134), "all of the facts in this proceeding have been stipulated, and they are not in dispute. In fact, *the petitioner has not concealed at any time any of its arrangements, but has made full disclosures of them,* at least as far as this proceeding is concerned," (See also Opening Statement of Government Counsel, R. 43-60) so every effort has been made to present to the Court not only what the parties did but also what they were thinking about and what they intended when they did it.

The Bank presents its position thus,—It made a sale of property for the purpose of sustaining a position it was maintaining in a controversy with the Comptroller of the Currency; it intended to repurchase the properties within a period of 30 days or so, but it wanted no binding agreement or commitment to that effect because it could not accomplish the purpose just stated unless the sale was complete and effective; it explained this to Capital Company when offering Capital Company the property so that there could be no misunderstanding about the deal; every formality was complied with to protect Capital Company as the owner of the property; although Capital Company said they would resell to the Bank if the Bank offered to repurchase, it was understood and agreed that the promise to resell was not to be a legally binding agreement, and it was obvious of course that until resale, Capital Company had all the benefits and burdens of ownership including any risk of loss in case of disaster; it (the Bank) made this sale for the sole and

exclusive purpose above stated and its only concern about income taxes was that it did not want to get into trouble with the income tax Bureau because of the fact that the resultant tax benefit from the loss on the sale might make it appear that it had entered into this transaction to avoid a tax; the question of affecting tax liability had nothing whatever to do with its decision to make the sale; the sale of the property was a real sale and intended as such and since the tax laws allow deductions for losses sustained in such sales, the loss claimed in this proceeding should be allowed.

(a) The Stipulation Shows Conclusively That the Sales Transactions Were Entered Into Solely for the Purpose of Effecting a Settlement of a Controversy With the Comptroller.

The stipulation (R. 31-41) shows the following: Paragraphs 1 to 4 inclusive (R. 32-34) describes the Bank's controversy with the Comptroller of the Currency about his demand that the Bank make a write-down of its Banking premises account and make a charge-off to its undivided profits account accordingly; they explain the Bank's position that the Comptroller had no authority to require such a write-down and further that the banking premises were worth the figure at which they were being carried on the books (See especially Exs. 1-A and 4-D attached to the Stipulation, R. 61, 66); they show that the settlement of the controversy was made upon the understanding that the Bank would effect the agreed-upon charge-off by a transaction which would establish a new cost basis on the properties on which the charge-offs were to be

made; *and as stated in paragraph 4 of the stipulation, "and, when the Bank agreed with the Comptroller to reduce its banking premises account in order to settle the issue with the Comptroller, it did so in the manner stated below to which the Comptroller had no objection."* (R. 34.)

Paragraph 5 of the Stipulation then opens with the statement, *"On account of the foregoing, the following transactions were effected"* (R. 34) and then follows a description of the sales transactions involving the sales of the banking properties from the Bank to Capital Company and later from Capital Company to Merchants. It is obvious that the stipulation establishes that the sales transactions were made "in order to settle the issue with the Comptroller" and "on account of the foregoing," the foregoing being the controversy with the Comptroller. *This stipulation leaves no room for any inference or argument that the sales transactions were entered into for tax purposes or for any purposes other than to effect a settlement of the controversy with the Comptroller.*

The Tax Court did say in its opinion that, "The evidence shows that possible tax advantages were an important consideration in arriving at the complicated form in which the simple requirement of the Comptroller was met." (R. 140.) However, The Tax Court might have doubted this because it immediately follows the statement with the assertion, "However, the ground for this decision is not whether or not the intent to effect a tax saving was the dominant purpose of petitioner." (R. 140.)

In order to avoid the chance that this Court might reach the same misunderstanding of the facts as The Tax Court did, attention is directed to the composition of the stipulation. As hereinbefore stated, the last sentence of paragraph 4 (R. 34), and the first sentence of paragraph 5 (R. 34) of the stipulation show that the *sole purpose* of the transaction was to effect the settlement with the Comptroller. The stipulation contains a paragraph in paragraph 5 as follows (R. 36):

> "The transactions described in sub-paragraph (a), (b) and (c) above were effected pursuant to and in accordance with this agreement. When these transactions were under contemplation, the Bank's officers were advised by the Bank's counsel that these transactions might result in a large deductible loss for income tax purposes. The Bank's officers thereupon instructed the Bank's counsel to make adequate disclosure of the transactions on the tax return so that the Internal Revenue Bureau would be fully informed thereof. The Counsel's memorandum of his discussion of the matter with the Bank officials is attached hereto as Exhibit 14-N."

The explanatory statement attached to the return pursuant to the instructions mentioned in the foregoing quotation is consistent with the stipulation that the sales were made solely to meet the Comptroller's requirements, and reads as follows (R. 108):

"Explanatory Statement as to Losses Included in Losses Reported in Schedule D.

The Comptroller of the Currency insisted that the cost less depreciation of certain properties owned by this bank exceeded its present value and that a charge-off had to be made to reduce the cost to present value. In order to accomplish this in a manner consistent with the Bank's policy and contention that its properties should be carried as cost (less reasonable allowance for current depreciation), it sold these properties to Capital Company. The selling price was fixed at the present value of the property and Capital Company paid the selling price in cash. At a later date Merchants National Realty Corporation, a wholly owned subsidiary of the Bank, purchased these properties from Capital Company, for cash, for the same price at which Capital Company had purchased them. The loss resulting from this sale is claimed on this return since the Income Tax Statute contains no provisions exempting either gain or loss from such a transaction from being included in computing net income. Furthermore, this loss should be deductible in any event as a loss, because it was taken in compliance with a requirement of the Comptroller of the Currency."

The Counsel's memorandum of his conference with Bank officials (Ex. 14-N, R. 91) shows that he was consulted at a time when a settlement of the controversy was imminent, and for the sole purpose of giving advice as to how the settlement could be effected in a manner consistent with the position which the Bank

was maintaining throughout the controversy. As shown in the memorandum, the only reason the matter of taxes was discussed was that the officers of the Bank were concerned whether the Income Tax Bureau might think that this unusual transaction was entered into as a scheme to defraud the Government out of taxes, and thus cause trouble for the Bank. (The memorandum shows, "The officers of the Bank inquired as to the results of such transactions for tax purposes and especially whether there was anything wrong in transactions such as this." (R. 93); also, "The Bank officers have asked me that I should instruct them as to the method of carrying out these transactions for the purposes indicated, and that I should be careful that the transactions should be properly disclosed so that there could be no misunderstanding of the transactions, or so that there could be no complaint on the part of the tax authorities that these transactions were made for the purpose of defrauding the Government or were not properly disclosed." (R. 94.) The postscript on the memorandum shows merely that the plan for working out the settlement was discussed with officials of the Comptroller's Office, who were told that it might have some effect upon tax liabilities and these officials stated in effect that they were unconcerned about the matter of taxes. (R. 95.) This does not indicate that the transactions were entered into for tax purposes,—it shows merely that the Bank wanted to be careful that by getting out of the trouble with the Comptroller's Office, it was not getting into trouble with anybody else, and it wanted to make full dis-

closure of any possible extraneous effects which might be caused by the settlement program.

The stipulation is conclusive as hereinbefore pointed out, that the only purpose of the sales transactions was to complete a settlement of the controversy with the Comptroller in a manner consistent with the position which the Bank had maintained throughout the controversy, and the effect of the transaction on the tax liability of the Bank was merely an incident of and not a purpose of, the transactions.

(b) The Stipulation Shows Conclusively That the Bank Sold Eight Parcels of Property to Capital Company in 1943.

Paragraphs 5 and 6 of the Stipulation (R. 34-38) show as The Tax Court stated "* * * that petitioner conveyed the legal title to the properties to Capital, and that it meticulously complied with all of the customary formalities necessary for the transfers of title" (R. 134) and further that in carrying out the sales transactions, "all formalities in connection therewith * * * were complied with * * *." (R. 131.) These paragraphs show that the properties were sold by the Bank to Capital Company for cash at a price equal to the appraised value of the properties. Paragraph 5(c) (R. 35-36) explains that just prior to the sale an officer of the Bank talked to an officer of Capital Company, explained to him the Bank's controversy with the Comptroller, and reached an agreement with him which in effect was as follows:

That the Bank would sell and Capital Company would purchase the eight parcels of property for cash

at a price equal to the appraised value of the property; that the Bank intended to and would repurchase the property within 30 days or so and Capital Company would resell the property to the Bank or to Merchants upon request of the Bank for cash at a price equal to the price paid by Capital Company plus acquisition costs, but there would be no written agreement between the Bank, Merchants and Capital Company concerning the resale or repurchase (R. 36); that after the purchase of the property by Capital Company the Bank would rent the property and pay a net rental therefor equal to a 6% return per annum to Capital Company on its investment in the property. (R. 36.)

The sales by the Bank to Capital Company were consummated pursuant to this agreement (R. 36), and all formalities incidental to the transaction, including the execution of a formal lease between the Bank and Capital Company with respect to each property, were complied with. (Paragraph 6, R. 37-38, Ex. 10-J, R. 81.) The rentals received by Capital Company under these leases were reported as rental income by Capital Company for income tax purposes, and were reported as rental expense by the Bank for income tax purposes. (R. 38.)

It is obvious from the foregoing description of the facts set forth in paragraphs 5 and 6 of the Stipulation, that the transaction between the Bank and Capital Company differs from a straight out-and-out sales transaction in only one particular, and that is that at the time of the sale the Bank told Capital Company

that it would like to repurchase, and intended to repurchase the property within a short period of time, and Capital Company told the Bank that whenever it wanted to repurchase Capital Company would resell the property to it, *and at the same time both parties agreed that they would not reduce this understanding to writing.* It was primarily because of this repurchase arrangement and the later sale by Capital Company to Merchants that The Tax Court concluded (1) that the sale was a sham, (2) that the Bank never intended to relinquish, nor did it relinquish, dominion and control over the properties, and (3) that Capital Company was a mere conduit for transferring the property to Merchants. Each and all of these conclusions are wrong and are not supported by the facts as stipulated, or by any applicable statutory provision, or by any principle or rule of construction pronounced or established by Court decision.

(c) The Tax Court Was Wrong in Concluding That the Sale to Capital Company Was a Sham. There Is No Support in the Facts or in the Law for Such a Conclusion.

The Tax Court refers to *Higgins vs. Smith,* 308 U. S. 473, *Gregory vs. Helvering,* 293 U. S. 465, *Burnet vs. Huff,* 288 U. S. 156, *Weiss vs. Wiener,* 279 U. S. 333, in support of its conclusion that the sale from the Bank to Capital Company was a sham and not *bona fide.*

The *Burnet vs. Huff* and the *Weiss vs. Wiener* cases stand for the proposition that a loss to be deductible must be actual and present. They recognize that a loss

resulting from a sale is an actual and present loss, so the cases are of no help in the determination of the real issue in this case—whether the sales to Capital Company (or to Merchants) should be recognized for tax purposes.

The *Gregory vs. Helvering* and the *Higgins vs. Smith* cases are pertinent but they do not authorize the disregard of business transactions where those transactions were entered into for business reasons not related to tax considerations, so they do not support The Tax Court's conclusion that the sale to Capital Company was a sham and not *bona fide*.

In the *Gregory* case, Evelyn Gregory, the petitioner, owned all of the stock of United Mortgage Corp. which held among its assets 1,000 shares of the Monitor Securities Corp. The petitioner planned to distribute these shares to herself in such a manner that the declaration of a dividend, which would be taxable as ordinary income, would be avoided. The Averill Corporation was formed to acquire the 1,000 shares of Monitor held by United Mortgage for which all the stock of Averill was issued to the petitioner, in compliance with Section 112(g)(1)(D), a reorganization section allowing tax exemption for such transactions. Three days later, Averill Corporation was liquidated. Its assets consisting of 1,000 shares of Monitor were distributed in cancellation of its outstanding stock, and the petitioner reported a capital gain on the exchange.

The Board of Tax Appeals decided that the Averill Corp. must be recognized and the reorganization

exemption allowed and consequently the receipt by Evelyn Gregory of the Monitor stock was taxable as capital gain and not dividend income. The Circuit Court of Appeals for the Second Circuit disagreed concluding that the only purpose of the reorganization transactions was to dodge the stockholder's income taxes which was not a true business purpose of either or both companies which were parties to the reorganization, that the transactions "so viewed—were a sham", and Congress could not have intended that the tax exemption should apply to reorganizations which had no real business purpose. The U. S. Supreme Court affirmed the Appellate Court, *Gregory vs. Helvering* (1935) 293 U. S. 465, on the general proposition that the intent of Congress in enacting Section 112(g)(1)(D) was not to allow a transfer of assets by one corporation to another under a plan of reorganization which had no relation to the business purpose of either.

The first time the Supreme Court had occasion to refer to the *Gregory* case, was in the case of *Helvering vs. Minnesota Tea Co.* (1935) 296 U. S. 378, which involved the question of whether a transfer of assets by one company to two separate companies constituted a reorganization, and in holding that it did, the Court stated, in referring to the *Gregory* case:

> "*Gregory vs. Helvering* * * * revealed a sham; a mere device intended to obscure the character of the transaction. We, of course, disregarded the mask and dealt with realities. The present record discloses no such situation; nothing suggests other than a bona fide business move."

When the *Minnesota Tea Company* case came back to the Court (1938—302 U. S. 609), to determine whether certain cash received by Minnesota Tea Company in the reorganization transaction and paid by it to its stockholders under a specific agreement that they would use it to pay the Company's debts, constituted a "distribution" exempting it from tax in the hands of the Company, the Supreme Court explained the applicable statutory provision and the problem in the case as follows:

> "These provisions plainly establish that, in respect of any cash received and not 'distributed', there was a taxable gain to petitioner. And, quite as plainly, payment of the debts by petitioner, if made directly by petitioner to the creditors, would not have been a distribution under the statute; for that contemplates a distribution to stockholders, and not payment to creditors. If, then, petitioner had followed the simple course of retaining in its own hands the sum here in question, and subsequently paying it directly to the creditors, it necessarily would result that liability of petitioner for a tax on the amount of gain could not be avoided. And, obviously, this is the effect of what was done, although circuitously."

The Court concluded:

> "Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different re-

> sult because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come into their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit. The controlling principle will be found in *Gregory v. Helvering,* 293 U. S. 465, 469, 470, 55 S.Ct. 266, 267, 79 L.Ed. 596, 97 A.L.R. 1355; and applying that principle here, the judgment of the Court below is confirmed."

In the case of *John Kelley Co. vs. Commissioner,* (1946) 326 U. S. 521, involving the question of whether payments on certain notes or securities constituted dividends or deductible interest, the Court had this to say about the *Gregory* case:

> "There is not present in either situation the wholly useless temporary compliance with statutory literalness which this Court condemned as futile, as a matter of law, in *Gregory vs. Helvering.* * * *"

It seems quite clear that *Gregory vs. Helvering* is intended to apply only in those situations where a "meaningless and unnecessary" transaction was entered into to effect a "temporary compliance with statutory literalness" for the sole purpose of obtaining a tax advantage, in which event the transaction is to be ignored as a sham. As will hereinafter be demonstrated, the transaction involved in the instant case before this Court does not come within the above described category.

In *Higgins vs. Smith* (1940) 308 U. S. 473, a corporation which was wholly owned by the taxpayer litigant, was engaged in a business restricted largely to operations in buying and selling securities from and to the taxpayer, and the purpose of the corporation and these transactions was to gain advantages of income and estate tax savings for the taxpayer, its stockholder. The question involved was the deductibility of a loss on some of these sales transactions from the taxpayer to the corporation. The District Court had instructed the jury to determine whether the sales were actual sales "out of Mr. Smith and into something that existed separate and apart from him" or whether they were to be regarded as simply a "transfer by Mr. Smith's left hand, being his individual hand, into his right hand, being his corporate hand, so that in truth and fact there was no transfer at all." The jury agreed that the latter situation existed. The Circuit Court of Appeals (2nd Circuit) reversed on the ground that the transfers were identifiable events establishing loss. The Supreme Court reversed the Appellate Court, and in its opinion used some very general language about the non-deductibility or non-recognition of a loss in sales of property between a sole stockholder and his wholly-owned corporation because of the retention of control over the property. The Court said:

> "Indeed this domination and control is so obvious in a wholly owned corporation as to require a peremptory instruction that no loss in the statutory sense could occur upon a sale by a taxpayer to such an entity."

This statement has not been applied literally so it must be construed in the light of the particular circumstances of the case and other language used by the Court in its opinion. For example, in commenting upon the fact that Congress had enacted Section 24 (a)(6) of the Revenue Act of 1934, explicitly forbidding losses in transactions between an individual stockholder and his controlled company and answering the argument that in view of that enactment the law was formerly otherwise, the Court stated:

> "At most it is evidence that a later Congress construed the 1932 Act to recognize separable taxable identities between the taxpayer and his wholly owned corporation. As the new provision goes much farther than the former decisions in disregarding transfers between members of the family, it may well have been passed to extend as well as clarify the existing rule. The suggestion is not sufficiently persuasive to give validity to a futile transfer."

(The Section 24(a)(6) of the Revenue Act of 1934 above referred to is still in the law as Section 24(b) of the Internal Revenue Code, *and it is significant that the Section does not forbid the deduction of losses in transactions between a corporation and its controlled subsidiary*. It applies only to losses in sales between an *individual* and his controlled corporation. It would not be applicable to a sale from the Bank to Merchants.)

It is difficult to avoid the conclusion from a reading of the case that the decision was induced by the fact

that the sales were made for the sole purpose of avoiding tax liability. For example, the Court stated:

> "The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is the command of income and its benefits which marks the real owner of property."

This Court—Court of Appeals for the Ninth Circuit, in its decision in the case of *Laughton vs. Commissioner* (1940) 113 F(2d) 103, recognized that the Supreme Court's opinion in the *Higgins vs. Smith* case was so composed that it is impossible to interpret any single expression in the opinion without reference to the whole context. In the *Laughton* case, Mr. Laughton, an actor, was employed under contract by a British Corporation, all of whose stock he owned. This Company "loaned" him to American producers at a compensation in excess of what the corporation paid him and the Government attempted to ignore the corporate entity and tax the entire compensation to Mr. Laughton. This appellate Court sustained the Board of Tax Appeals in holding that the corporate entity could not be ignored. After a careful analysis of the Supreme Court's decision in *Higgins vs. Smith,* the Court concluded:

> "It is arguable that the Higgins decision means that no matter what the particular 'tax event'

> may be, if it be more profitable to the tax collector to disregard the intervening corporate entity this must be done. However, it seems to us that if this were the intent of the court it would have said so and not spread its consideration of the cases over many pages of the opinion with such qualifying language as is quoted above.
>
> We take the opinion to mean that the 'tax event' is not an unreal attempt to use a corporation for a sham transaction, procuring an advantageous tax consequence to the taxpayer, if it may be considered as one primarily for an independent business purpose and not a transfer of assets (here Laughton's services), with a retention of their control, solely to reduce tax liability."

And in the case of *Samson Tire & Rubber Co. vs. Riegan* (1943) 136 F(2d) 345, 347, this Court stated:

> "It is true that, for tax purposes, a transaction which is unreal or sham may be disregarded. *Higgins vs. Smith.* But a real transaction, having an independent business purpose, may not be disregarded, though designed to procure 'an advantageous tax consequence' ". *Com. vs. Laughton,* supra (113 F(2d) 104).

This Court's interpretation of the *Higgins vs. Smith* case has support in the reference which the Supreme Court made to its *Higgins vs. Smith* decision the first time it referred to it, which was in the case of *Moline Properties, Inc.,* 319 U. S. 439.

In *Moline Properties Inc. vs. Commissioner,* (1943) 319 U. S. 439, there was a question as to whether certain profits made by the Corporation with a limited

business, should be taxed to the corporation as claimed by the Government, or to the sole stockholder. After emphasizing the rule that the corporate identity should not be ignored or disregarded, the Court stated:

> "In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction. *Higgins vs. Smith* * * *, *Gregory vs. Helvering* * * *".

The Court held the income properly taxed against the Corporation.

There are a great many cases in which *Gregory vs. Helvering* and *Higgins vs. Smith* have been followed or distinguished. In every case in which the decisions have been followed there existed the element of tax avoidance as the inducement for the questioned transaction. *We have not been able to find a single case in which a transaction entered into for a purpose entirely foreign to tax considerations was ignored.*

In *Commissioner vs. Capento Securities Co.,* (C.C. A.-1-1944) 140 F(2d) 382, the Court held that *Gregory vs. Helvering* was not applicable, concluding, "in the case at bar the reorganization was not resorted to in order to evade an impending tax liability." In *Electrical Securities Corp. vs. Commissioner,* (C.C.A. -2-1937), 92 F(2d) 593, Judge L. Hand indicated that it was his view of *Gregory vs. Helvering,* that a transaction was a "sham" if its only purpose was to avoid a tax and the medium used to achieve such a result had no other business purpose. In *Richard H. Survaunt,* 5 T.C. 665, Aff'd. C.C.A.-8-1947, 162 F(2d)

753, a reorganization was not disturbed even though the stockholders had a personal—as opposed to a corporate—reason for the arrangement. Similarly, a reorganization for the convenience of stockholders was upheld in *Souther,* (1939) 39 B.T.A. 197, 214-216. In *Commissioner vs. Kolb,* (1938) 100 F(2d) 920, this Court found that reasons, both for the convenience of the corporation and of the preferred and common stockholders, were sufficient to uphold the reorganization. These are some examples of situations in which the Courts have refused to disregard transactions which were not entered into solely for tax considerations.

The foregoing analysis of the authorities shows conclusively that The Tax Court was wrong in this case in concluding that the doctrine of the *Gregory vs. Helvering* and *Higgins vs. Smith* cases requires a disregard of the sales of property by the Bank to Capital Company and the sales by Capital Company to Merchants. The transactions were consummated legally and effectively, they were made for a definite purpose not related to taxes, and they were not made to avoid tax liability. Under these circumstances the *Gregory vs. Helvering* and the *Higgins vs. Smith* cases cannot apply. Since these decisions and the principles applied therein do not apply, the sales to Capital Company must be regarded and accepted as *bona fide,* and they cannot be classified as mere sham.

The establishment of the sales as *bona fide* eliminates one of the grounds on which The Tax Court based its refusal to recognize the sales, but it does

not necessarily require the allowance of a loss resulting therefrom. If the sales were not closed and completed transactions, which is another ground on which The Tax Court based its refusal to recognize the sale, no loss can be recognized. The question of whether these sales qualify as closed and completed transactions is something different from the question of whether the sales were *bona fide* and real. This question will now be answered to show that the sales were closed and completed transactions, and qualify as transactions from which gain or loss must be recognized for tax purposes.

(d) The Sales to Capital Company Were Closed and Completed Transactions and Gain or Loss Realized Therefrom Must Be Recognized for Tax Purposes. The Tax Court Was Wrong in Concluding That They Could Not Be Recognized as Closed Transactions and That Capital Company Was a Mere Conduit for a Transfer of the Property to Merchants.

The Tax Court concluded that Capital Company "was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants". (R. 138.) The Court also stated that, "Capital was obligated to deliver deeds to the eight branch banks back to petitioner or Merchants, and the parties never intended, under any circumstances, that Capital should retain title to any of the eight properties." (R. 138.) This conclusion, if it is intended to be taken literally as it would have to be interpreted if it is to be sufficient to sustain the Court's decision that the sale to Capital Company must be disregarded, is contrary to the facts as stipulated. Again, a careful analysis of the facts is important.

Enough has already been said about the facts to establish that the sales from the Bank to Capital Company were made to settle the controversy with the Comptroller of the Currency in a manner consistent with the position which the Bank had maintained throughout the controversy. The Bank's position was that it had the right to carry its banking premises on its books at cost less ordinary depreciation and that the Comptroller had no authority to require a write-down. (Stip. Paragraph 4, R. 34.) When the proffered settlement required a charge-off how could the Bank effect the charge-off without making it a straight write-down and thus being put into a position of having established a precedent for possible similar action on the part of the Comptroller in the future? That was the question which the Bank officers asked of their counsel. (Ex. 14-N, R. 91.) The counsel's memorandum reflects quite clearly, the line of thinking on the part of the Bank officials during the conference with the Bank's counsel. The memorandum shows that in response to their question he "advised them that they could probably arrange to purchase and sell properties between the Bank and Merchants National Realty Corporation, so that the purchase price of the respective properties would be a figure satisfactory to the Committee and in accordance with the agreement." (Ex. 14-N, R. 82.) The response to this answer is very significant since it shows that the Bank officials were of the opinion that such a transaction did not result in a sufficient divesting of control of the properties by the Bank to sup-

port a claim that a real sale had been made and a new cost established. The memorandum explains this response as follows:

> "The Bank officers felt that since it was a transaction between the parent and a wholly owned affiliate, the purchase and sales transaction might be ignored and the transaction considered a write-down which would establish a precedent whereby the Bank might be compelled to continue the practice of arbitrarily writing down its banking premises. The Bank, of course, did not wish to establish a precedent or to be in a position where it could ever be faced with the contention that it had previously recognized the legality of any requirement by the Comptroller of the Currency that banking premises should be arbitrarily written down." (Ex. 14-N, R. 92.)

The objection of the Bank's officers led to an obvious suggestion—sell to some outside interest! So, the Counsel's memorandum continues:

> "I then suggested that if the Bank and Merchants National Realty Corporation should be willing to assume the risks which might result where property is removed from their hands even for a short period of time, they might arrange with some other company, such as Capital Company, to purchase the property from one and then sell to the other." (Ex. 14-N, R. 92.)

The Bank officers agreed to follow this program and asked the Bank's Counsel, "that I should instruct them as to the method of carrying out these transactions for the purposes indicated * * *." (Ex. 14-N, R. 94.)

There can be no doubt that the Bank wanted to make a sale of property in such manner that it would be completely divested of ownership and control for a period of time. It was only through such a transaction that the Bank could make a charge-off of a loss as a loss from sale rather than as a straight write-down of book costs.

After this conference with the Bank's Counsel, an officer of the Bank entered into negotiations with the President of Capital Company. The Bank's position was fully explained and an agreement was reached as explained in paragraph 5(c) of the Stipulation (R. 35-36), in effect as follows:

(1) That the Bank or Merchants would sell particular properties to Capital Company for cash for a price equal to the appraised value of the respective properties.

(2) "That the Bank intended to and would" repurchase, the properties within thirty days or so after their sale to Capital Company, and "Capital Company agreed" to resell the properties to the Bank or Merchants for cash for the same amount it had paid for the properties plus acquisition costs, "at any time upon request of the Bank."

(3) "That there would not be any written agreement between the Bank, Merchants and Capital Company," concerning the resale of the property.

(4) That while Capital Company owned the property, "the Bank would pay to Capital Company as rental amounts equal to 6% per annum net upon the

amounts paid by Capital Company" for the properties.

It was stipulated that the transactions "were effected pursuant to and in accordance with this agreement," (R. 36) and it was further stipulated in paragraph 6 of the stipulation (R. 37), "in carrying out the aforesaid transactions, all formalities in connection therewith, such as the execution and recording of deeds, the affixing of documentary stamp taxes, the transfer of fire insurance, and the recording of the transactions on the books of all companies as purchases and sales of property were complied with. When the properties were deeded to Capital Company, the outstanding fire insurance policies covering the respective properties were amended by rider to provide that any loss payable thereunder should be paid to Capital Company; and when Capital Company deeded the properties to the Bank or to Merchants the policies were again amended by rider to provide that any loss payable thereunder should be paid to the Bank or to Merchants respectively." Upon the sale to Capital Company, "the Bank and Capital Company executed" a comprehensive lease agreement (Ex. 10-J, R. 81) "with respect to each property, and the rentals received under said lease agreements were reported by Capital Company as rental income on its income tax return, and by the Bank as rental expense on its tax return." (R. 38.)

The transfer of property for a monetary consideration is a sale. The above statement of facts taken from the stipulation leaves no room for any other con-

struction than that the Bank sold properties to Capital Company, transferring all title and control to Capital Company for a cash consideration amounting to $2,-853,000. (Ex. 8-H, R. 79.) This is not a case of a "temporary compliance with statutory literalness" for the purpose of obtaining a tax advantage, condemned by *Gregory vs. Helvering* (*John Kelley Co., Supra,* 326 U. S. 521). It is a case of a careful, deliberate and literal compliance with statutory requirements involving a sale of property from a seller to a buyer, to protect the buyer from any defect in the transaction which might jeopardize an investment of over $2,800,000 in the property. This was a real transaction, not a sham.

The agreement between the Bank and Capital Company *not* to reduce to writing the understanding as to the resale of the property, was deliberate and not without purpose. As hereinbefore pointed out in the discussion of the Counsel's memorandum (Ex. 14-N, R. 91), supra, p. 23, the Bank officials were cognizant of the fact that to do what they wanted to do, to have the effect they wanted it to have, they would have to negotiate a sale which could have no legal detriment, a sale which would completely and effectively divest the Bank of title and control of the property, and it is stipulated that this was explained to Mr. Woodruff, President of Capital Company when the sales were negotiated. Although the Bank represented that it intended to and would repurchase the property and Capital Company agreed that it would resell at any time the Bank offered to repurchase, both

parties *deliberately agreed not to reduce this to writing which is a specific agreement that the repurchase agreement was not to have legal effect.*[1]

This was not a "meaningless and unnecessary incident" of the transaction of the type condemned in the *Minnesota Tea Company* case, *Supra* (302 U.S.

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[1]Sections 1971 and 1973 of the California Code of Civil Procedure:

"*1971. Transfer of real property to be in writing.* No estate or interest in real property, other than for leases for a term not exceeding one year, nor any trust or power over or concerning it, or in any manner relating thereto can be created, granted, assigned, surrendered, or declared, otherwise than by operation of law, or a conveyance or other instrument in writing, subscribed by the party creating, granting, assigning, surrendering, or declaring the same, or by its lawful agent thereunto authorized by writing.

1973. (What agreements must be in writing.) In the following cases the agreement is invalid, unless the same or some note or memorandum thereof be in writing, and subscribed by the party charged, or by his agent. Evidence, therefore, of the agreement, cannot be received without the writing or secondary evidence of its contents:

1. An agreement that by its terms is not to be performed within a year from the making thereof;
2. A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in section 2794 of the Civil Code;
3. An agreement made upon consideration of marriage other than a mutual promise to marry;
4. An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; and such agreement, if made by an agent of the party sought to be charged is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged;
5. An agreement authorizing or employing an agent or broker to purchase or sell real estate for compensation or a commission;
6. An agreement which by its terms is not to be performed during the lifetime of the promisor, or an agreement to devise or bequeath any property, or to make any provision for any person by will;
7. An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of said indebtedness by the purchaser is specifically provided for in the conveyance of such property."

609). It was a necessary incident to accomplish what both parties intended, namely, that the sale from the Bank to Capital Company was to be a completed transaction effecting a transfer of complete title, control and domination of the property from the Bank to Capital Company. It was only by such a transaction that the Bank could accomplish its objective with respect to the settlement of the controversy with the Comptroller, and Capital Company was aware of that fact.

It was because the parties were so very careful to accomplish such a transfer, that Capital Company had to be so careful that its position as owner of the property with an investment therein of over $2,800,000 was protected during the period it owned the property. During this period it had all the benefits, burdens and risks of ownership of the property. Had there been a disaster during this period, any loss not covered by insurance would have fallen upon Capital Company. It received the rental income from the property and reported it as such on its income tax returns. *The Government has not questioned these rentals so to that extent at least it has recognized that Capital Company had control and ownership of the property while it had title to the property.*

This Court stated in the case of *Rasmussen vs. Eddy's Steam Bakery* (1932) 57 F (2d) 27 (cert. denied), "The question of title and income are inextricably interwoven. It characterizes the possession of the property and determines the ownership of the income thereof." Under this principle the taxing of

the income to Capital Company characterizes it as the owner of the property. The recognition of Capital Company as the owner of the property must necessarily require recognition of the transaction by which it became the owner.

The above recital of the facts shows conclusively that there is no factual support whatever for the conclusion that Capital Company was, and was intended to be, a mere conduit for transmittal of the property from Bank to Merchants, or for the further conclusion that the Bank did not transfer, and never intended to transfer, complete title, dominion and control of the property to Capital Company. The facts establish that the parties intended that the sale should be a closed and completed transaction; they intended that the Bank should be divested of all title, dominion and control of the property immediately upon the sale to Capital Company; they intended that Capital Company should have exclusive title, dominion and control and all benefits and burdens of ownership while it was the owner of the property and until such time as it might resell the property to the Bank; and the actual mode of transfer and the formalities which were followed, carried out the intentions of the parties.

The Tax Court seemed to think that the repurchase arrangement, with the subsequent repurchase, justified a conclusion that the sale to Capital Company could be considered merely a step in the consummation of a single transaction—a transfer to Merchants—and on the principle that the separate steps of an

integral transaction must be construed taxwise by the results accomplished upon the consummation of the entire transaction, the sale to Capital Company could be disregarded. As will immediately hereinafter be shown *this principle never applies where the parties intended the separate steps as separate and distinct transactions, unless the real intent and the sole purpose of the transaction was tax avoidance.*

(e) The Sales to Capital Company and From Capital Company to Merchants Were Separate and Distinct Transactions and in the Absence of Any Intention to Avoid Tax, They Cannot Be Treated as a Single Transaction Involving a Sale From the Bank to Merchants, and the Sale to Capital Company Cannot Be Disregarded.

The mere fact that Merchants purchased the properties after Capital Company had owned them for 30 days or so cannot vitiate the original sale. Prior to the enactment of Sections 23 (j) and 118 of the Internal Revenue Code taxpayers could almost simultaneously sell and repurchase securities and deduct the loss resulting from the sale. (*Pennsylvania Co. for Insurance vs. Commissioner* (1925) 2 BTA 48.) Although Sections 23 (j) and 118 provide for the disallowance of the loss from such a sale they do not relieve the taxpayer from tax on any gain resulting from such a sale. Furthermore, the Sections apply only to wash sales occurring within a thirty-day period. If a taxpayer sells stock at a loss with a deliberate intent of repurchasing the stock on the 31st day after the sale regardless of price, he may deduct the loss.

There is nothing in the statutes which requires a taxpayer to hold *real estate* any particular length of time as a condition to the deductibility of any loss from the sale of the property (excepting as recognition of loss is affected by the capital gains and losses sections not involved in this proceeding).

In the case of *U. S. vs. Cumberland Public Service Company* (1950) 70 Sup. Ct. 280, shareholders of a corporation sold property immediately after receiving it as a liquidating dividend for the specific purpose of selling it, and the Supreme Court refused to disregard the transaction as a sale by the shareholders, and the Court refused to construe the transaction as a sale by the Corporation which had made the distribution, and therefore refused to apply the principle that the separate steps could be ignored and the transaction considered as a sale by the Corporation and a distribution of the proceeds to the stockholders as a liquidating distribution. There is an accepted doctrine that where several steps must be taken to accomplish a certain objective and the separate steps are not intended to be independent but are intended only as a means for accomplishing the objective, the separate steps may be ignored and the transaction may be viewed as a single transaction from the position of the taxpayer at the start to the position of the taxpayer after the accomplishment of the objective. This doctrine seems to be limited quite generally to reorganization transactions where several steps are usually necessary to complete the reorganization. It is also applied, however, to cases

where a single step is deliberately separated to avoid a tax. It is never applied to permit a closed transaction to be ignored merely because it is followed by another completed transaction involving the same subject matter, regardless of how closely the one might follow the other in formality or point of time. We have been unable to find a single case where separate transactions were treated as one where the parties intended the transactions to be separate and where the purpose of the transactions did not involve tax avoidance.

In the case of *J. D. Bigger* (1930) 19 BTA 797, a taxpayer contributed $1200 to a syndicate under a plan whereby the syndicate was to acquire certain oil leases and transfer them to an operating corporation for stock. This was accomplished within a period of a few months. The Court described the issue—"If the Board considers this transaction as a continuing one and in effect a purchase by the petitioner of shares of stock in the Emerald Petroleum Co. through the medium of the syndicate to which cash was advanced prior to the organization of the corporation, but in pursuance to the general plan of its formation, then the petitioner realized no profit. If, on the other hand, the Board agrees with the contention of the Commissioner that the purchase by the petitioner of an interest in the syndicate constituted a closed transaction from which profit was realized when an exchange of such interest for stock was effected and that said stock had a market value of $20 per share, the taxpayer realized a profit of $2,480."

In its opinion, the Board of Tax Appeals analyzed the applicable legal principle as follows:

> "So-called continuing transactions, involving separate and distinguishable steps in a general plan, have been considered by us in cases resulting from the merging or reorganizing of corporation. In the case of *William H. Mullins,* 14 B.T.A. 426, we said:
>
> > * * * The fact that these several transactions together comprised a single plan of reorganization does not render them any the less separate and distinct undertakings. The nature of each transaction is determinable from the facts relating to it, and is not changed because of its association with other transactions in a larger and more comprehensive plan.'
>
> The petitioner's contribution of $1,200 to the syndicate, by which he acquired a direct interest in the oil leases, was a distinct step in the general plan, and, even though in contemplation of the ultimate receipt of shares of stock in the operating company, constituted a closed transaction at least for tax purposes. *Edward A. Langenbach,* 2 B.T.A. 777; *B. F. Saul,* 4 B.T.A. 639; *William H. Mullins, supra,* cf. *A. J. Siegel,* 4 B.T.A. 186; affd., 25 Fed. (2d) 1022; *J. A. Staley,* 9 B.T.A. 932; *T. B. Noble,* 12 B.T.A. 1419; affd., 5th Cir., C.C.A., Oct. 21, 1929. * * *
>
> We accordingly hold that the purchase by the petitioner of an interest in the syndicate and the subsequent exchange of that interest for shares of stock in the corporation resulted in taxable gain as found by the respondent. *E. C. Huffman,* 1 B.T.A. 52; *V. J. Bulleit,* 3 B.T.A. 631; *Napoleon*

B. Burge, 4 B.T.A. 732; *Douglas F. Fesler,* 13 B.T.A. 1356; 38 Fed. (2d) 155; *R. V. Board,* 14 B.T.A. 374; *Edward H. Mount,* 16 B.T.A. 847; *Cullinan v. Walker,* 262 U. S. 134."

In *Chandler Shipbuilding Co. vs. Commissioner,* (1931) 22 B.T.A. 5, a partnership wanted to exchange assets for stock of a newly organized corporation, but in order to meet the requirements of the Corporation Commissioner the partnership bought the stock for cash and the corporation immediately used the cash to buy the assets. In holding that the transaction was not an exchange of assets for stock but was a purchase of stock for cash entitling the company to use the amount paid as part of its invested capital, the Board stated:

> "It was the incorporator's direct purpose not to exchange shares for assets, because such a method would have required several months for an official valuation, and it was this delay which petitioner sought to and did avoid * * * *Under such circumstances it cannot be held that the method of organization chosen involved vain steps to which substantive effect should now be denied, when such method was deliberately and openly adopted for substantial reasons at the time.*" (Italics ours.)

In commenting upon this case later the Board said:

> "It is only in those instances where the evidence warrants the conclusion that the steps taken or acts done were never intended to be of substantive effect that disregard of form is justified. *Ralph F. Chandler Shipbuilding Co.,* 22 B.T.A.

5." (*Bancitaly Corporation* (1936) 34 B.T.A. 494, 506.)

This Court gave approval to this principle in the case of *First Seattle Dexter Horton National Bank vs. Commissioner* (1935) 77 F. (2d) 25; Cf. *U. S. vs. Santa Inez Co.* (1945) 145 F. (2d) 667.

The facts as stipulated show conclusively that the sales to Capital Company were intended to be of substantive effect—the very purpose and objective of the Bank required that the transaction be of substantive effect and accomplish a complete divestment of title and control of the properties sold, and the facts show that the sales were not made to avoid a tax, so the sales must be recognized as independent transactions from which gain or loss is determinable under applicable provisions of the income tax statutes, and the sales cannot be ignored as a mere medium for conveyance of the property to Merchants.

In *American Bantam Car Co.* (1948), 11 T. C. 397, Aff'd. C.C.A.-3-1949, 177 F. (2d) 513, three individuals transferred assets to a corporation in June 1936, at the same time agreeing with stock underwriters that upon their distribution of preferred stock of the new company they would receive a certain part of the common stock issued to the three individuals. When the common stock was first issued the three individuals had control so Section 112(b)(5) would be applicable and the basis of the property to the corporation would be the same as the basis in the hands of the transferor. (Section 113(a)(8).) After the preferred

stock was issued and the underwriters received some of the common stock, the three individuals did not have "control." The Tax Court explained the taxpayer's position as follows:

> "Petitioner, however, contends that the series of steps organizing the new corporation, transferring assets to it, and arranging for the sale of its preference stock must be considered as parts of the integrated plan formulated in May 1936, and, therefore, considered as parts of a single transaction. It argues that this unified transaction started on June 2, 1936, when petitioner was incorporated, and ended in October 1937, when the public offering of the preferred stock by the underwriters ceased and Grant was awarded 87,900 shares of common stock; that the transfer of common stock to Grant in 1937 was the final step in an indivisible operation and must be viewed concurrently with the preceding steps. On this theory the associates did not obtain control of petitioner, for on consummation of this final step in the general plan the associates had only 212,100 shares of common stock, while Grant had 86,900 shares and the public had 1,008 and there were 83,618 shares of outstanding preferred stock owned by the public. The 212,100 stock votes held by the associates in October 1937 fell shy of the required 80 per cent to give the requisite control."

The Tax Court then gave a very interesting explanation of its view as to the test to be applied in determining whether a series of transactions should be considered a single transaction for tax purposes. It said:

> "In determining whether a series of steps are to be treated as a single indivisible transaction or should retain their separate entity, the courts use a variety of tests. Paul, Select Studios in Federal Taxation, 2d series, pp. 200-254. Among the factors considered are the intent of the parties, the time element, and the pragmatic test of the ultimate result. An important test is that of mutual interdependence. Were the steps so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series?"

In applying the test the Court stated:

> "The standard required by the courts to enable them to say that a series of steps are interdependent and thus should be viewed as a single transaction do not exist here. It is true that all the steps may have been contemplated under the same general plan of May 1936; yet the contemplated arrangement for the sale of preferred stock to the public was entirely secondary and supplemental to the principal goal of the plan—to organize the new corporation and exchange its stock for the Austin assets. The understanding with the underwriters for disposing of the preferred stock, however important, was not a *sine qua non* in the general plan, without which no other step would have been taken."

The Court then concluded that the transfer of assets for stock was an independent transaction and subject to whatever tax effect would have to be given it under the Statute, that it came within Section

112(b)(5) and therefore the basis of the assets was the transferor's basis under Section 113(a)(8).

The test prescribed by The Tax Court is simple and clear cut. If applied to the case now under consideration there could be no doubt that the sale to Capital Company would have to be considered independent of the "informal" option to the Bank to repurchase, and independently of the later sale from Capital Company to Merchants. Paraphrasing the language of The Tax Court in the *American Bantam Car Co.* case, "The understanding with" Capital Company for resale of the properties, "however important, was not a *sina qua non* in the general plan, without which no other step would have been taken."

The record in this case establishes that the primary purpose was to make a binding unconditional sale of the property to Capital Company to accomplish a certain objective unrelated to taxes. The understanding about the resale of the property by Capital Company was purposely legally unenforceable; the Bank could have decided not to repurchase the property, and Capital Company could have sold to someone else, and in either case the validity of the original sale to Capital Company would not have been affected. The object of the original sale was to accomplish a result which could be accomplished only by that sale. The later sale to Merchants was "entirely secondary and supplemental to the principal goal of the plan", and could contribute nothing to the accomplishment of that goal, so it could not be treated as a transaction so interdependent or indivisible with the original

transaction as to warrant a disregard of the original sale as a separate transaction. Applying The Tax Court test, were the steps so interdependent that the legal relations created by the original sale to Capital Company would have been quite fruitless without the resale to the Bank or Merchants? Absolutely not! Actually, The Tax Court determination of the transaction as a single transaction involving a sale from the Bank to Merchants is in direct conflict with the recognized test, because if the transaction were one, as so construed, it would have been "fruitless" and useless for the accomplishment of the only purpose for which the transaction was effected—the establishment of a loss on the sale to Capital Company, to meet the requirements of the Comptroller. The transaction as construed by The Tax Court has no relationship to the business purpose which prompted the real transaction. It is like calling a cat a dog! The Bank made a sale to Capital Company for a particular business purpose. The Tax Court says the Bank did not sell to Capital Company but sold to Merchants. Why would it sell to Merchants? *The record shows that it was especially conscious that it could not fulfill its business purpose by selling to Merchants so it deliberately sold to Capital Company instead.* (Ex. 14N, R. 91) Just as the Court concluded in the *American Bantam Car* case that to ignore the issuance of the 300,000 shares of stock to the three individuals would require an unsupportable conclusion that title to those shares was suspended until the underwriters received part of them, so also it might be said in this case that to ignore the sale to Capital Company requires an

unsupportable conclusion that title to the property was suspended until the Bank should repurchase the property. The stipulation shows that Capital Company acquired and held title and ownership of the property and realized income therefrom which it reported as rental income on its tax return.

It is one thing to construe separate steps as a single transaction where the objective of the transaction is to go from the first to the last step to accomplish a desired business purpose; but it is something else again to ignore the very transaction consummated to effect the desired business purpose and to construe the transaction as one entirely different from what the parties intended and which really has no point or purpose, and one which the parties never would have entered into and deliberately refrained from entering into. Neither the test set forth in the *American Bantam Car* case nor any other rule of construction or of law justifies such a conclusion.

So far, it has been established that the sale to Capital Company was a bona fide sale. It was made for a purpose unrelated to tax avoidance and effectively divested the Bank of all title and control over the property sold. It was deliberately intended that such divestment of title and control should continue at least for a period of time. It has been established that under these circumstances the sale must be recognized for tax purposes, separate and apart from the later sale by Capital Company to Merchants. The only point remaining of those which The Tax Court discussed in its refusal to recognize the sale, is whether

the understanding regarding the possible repurchase of the property by the Bank or Merchants is sufficient to warrant the conclusion that the sale to Capital Company was not a closed and completed transaction.

(f) The Sales to Capital Company Were Closed and Completed Transactions and the Tax Consequences of These Sales Could Not Be Affected by the Later Sale of the Properties by Capital Company to Merchants. The Tax Court was Wrong in Concluding That the Understanding About the Resale of the Property by Capital Company Vitiated the Sales to Capital Company and Justified a Disregard of These Sales for Tax Purposes.

The Tax Court in concluding that the sale could not be recognized as a closed and completed transaction, relied upon *Shoenberg vs. Commissioner,* 77 F (2d) 446 and similar cases.

In *Sydney Shoenberg vs. Commissioner* (CCA-8-1935), 77 F (2d) 446, cert. denied, affg. 30 B.T.A. 659, the taxpayer gave instructions to a broker to sell certain personally owned stocks and at the same time instructed the broker to buy identical quantities of the same stocks on behalf of a corporation of which petitioner was president and in complete control. At the expiration of 30 days the corporation transferred the stocks to petitioner in his personal capacity. The basic premise of the transaction was to avoid taxes. On the evidence the Board concluded that the corporation was for all practical purposes an alter ego of the taxpayer, being entirely dominated by him; and since the whole transaction showed *a persistent intention* by the taxpayer to hold title and dominion over the stocks it did not amount to a bona fide sale, citing

Sharp vs. Commissioner, 38 B.T.A. 166, 174. The Appellate Court explained a philosophy of taxation which requires that a loss to be allowable as a deduction, must be a real loss sustained in a closed transaction and a loss from a sale of property is not real if the sale is made part of a plan whereby the same property or substantially identical property is to be reacquired and that plan is carried out. In this case the Court concluded, "Examining the entire transaction, it is clear that this sale by the taxpayer was merely a part of a plan by which he hoped to create a deductible loss without any real change in his position". Again the spectre of unsympathetic reaction to a transaction having no other purpose than tax avoidance!

In a later decision in the case of *Helvering vs. Johnson* (1939) 104 F (2d) 140, the Court of Appeals, 8th Circuit, which had decided the *Shoenberg* case, allowed a deduction for a loss on a sale by a taxpayer to a corporation which he controlled and 50% of whose stock he owned. In referring to *Commissioner vs. Dyer* (CCA-2-1935) 74 F (2d) 685, *Rand vs. Helvering* (CCA-8-1935) 77 F (2d) 450, and *Shoenberg vs. Commissioner,* Supra, the Court described those cases as involving a situation "where a *pretended* sale of stock is made under a plan which contemplates the reacquisition of the stock sold or its equivalent." The Court pointed out that the vendee company was not organized for tax advantage, so the Court would not construe the sale as a transaction in which the taxpayer retained control of the property through control

of the corporation, and the Court would not disregard the tax effects of the sale.

Where a sale is actually made, and is not merely a "pretended" sale, it must be recognized for tax purposes as a sale even though the purchaser might have purchased the property as an accommodation to the seller.

In *J. Harold Frantz*, B.T.A. Memo Docket 82426, Oct. 15, 1938, a corporation "accommodated" the taxpayer by purchasing certain land from him although the corporation did intend to use the land for a business purpose. At the time of the purchase, the corporation agreed verbally with the taxpayer that he could repurchase the land at the same price, if it remained unsold. A few months after this transaction, the taxpayer reacquired the property. The Board held that the loss on the sale was allowable, and that the verbal agreement for repurchase was an option which did not prevent the sale from being a closed transaction from which a deductible loss was sustained, citing *Helvering vs. San Joaquin Fruit & Investment Co.*, 297 U. S. 496.

In the case of *Bancitaly Corp.* (1936) 34 B.T.A. 494, 513 to 516, the taxpayer was acquiring a bank in New York and the Comptroller of the Currency refused to give the Bank a permit to establish a trust department unless the taxpayer holding company disposed of all of the stock of the Bank within six months. In an effort to comply with this requirement the taxpayer holding company transferred 150,000

shares of the stock to National Bankitaly Co., its securities dealer affiliate which had a sales organization and other facilities for selling the stock to the public. The transfer was effected in the form of a sale of the stock at $225.00 per share with the understanding that the parent company would take back any shares which National Bankitaly Co. could not sell. In a few months the market weakened and the stock dropped in value to $195.00 per share, whereupon Bancitaly Corp. took back the unsold balance of 84,198 shares giving credit of $225.00 per share therefor to National Bankitaly Co. and Bancitaly Corp. thereafter distributed the remaining stock to its stockholders as a dividend distribution. The Government and the Board of Tax Appeals held that the transfer of the 150,000 shares involving a profit of some $18,000,000 was one completed transaction so the entire profit was taxable, and the second transaction was a purchase of stock and a separate and distinct transaction, notwithstanding the agreement between the affiliated companies for a take-back of the unsold shares. (See dissenting opinion 34 B.T.A. 516.) The majority concluded, "Though there was, in a certain sense, a relationship between the two transactions, it was not such a relation as to make the two transactions one in law or to make the original sale incomplete or conditional. See *Jacob M. Dickinson,* 18 B.T.A. 790; *Daisy M. Ward,* 29 B.T.A. 1251".

Bancitaly Corp. was a predecessor of Transamerica Corp. which prior to 1937 owned all of the stock of the Bank of America, the appellant herein. The Tax

Court in this proceeding distinguishes the *Bancitaly Corp.* case by the terse statement "as the basis for the holding that taxable income was realized, the Board expressly found as a fact that the sale of 150,000 shares of stock and the subsequent repurchase of 84,198 of the shares were two separate and independent transactions and that the original purchaser was under no obligation to resell any of the shares to petitioner. In this proceeding, however, Capital was merely a conduit for the passage of title to the eight bank properties from petitioner to Merchants." (R. 137-138.) In appellant's viewpoint this is a distinction without a difference and if, as we think is established in this brief, the Tax Court has improperly construed the facts in determining that the sale to Capital Company and the sale to Merchants were not separate transactions, there is no difference between the cases.

Naturally the appellant does not relish a rule of construction which does not work both ways. In both the *Bancitaly Corp.* case and this case, transactions were effected to meet requirements of the Comptroller; in both cases there was no tax avoidance inducement or reason for what was done; in the *Bancitaly Corp.* case there was an agreement with an affiliated company to take back unsold stock, whereas in this case there was an understanding with Capital Company (not an affiliated company) that the property would be resold if the Bank wanted to repurchase, but the original sale was deliberately intended to be a closed and completed transaction; in the *Bancitaly Corp.* case there was a very substantial proft which was taxed—actually an unrealized profit in the sense that

the affiliated group ever reduced it to cash realization, in this case there is a loss for which no deduction is being allowed. The instant case presents a so much stronger factual basis than the *Bancitaly Corp.* case for a conclusion that the original sale was a closed and completed transaction, that the *Bancitaly Corp.* case must be acknowledged as an authority supporting the Appellant's position in this case that the agreement about a possible repurchase of the property was not sufficient to avoid the tax consequences of the original sale as a closed and completed transaction for tax purposes. *Certainly if a profit had been realized on the sale to Capital Co. the profit would be recognized and taxable*—the answer should be the same in the case of a loss. There was "retained control" of the stock originally sold by Bancitaly Corp. and yet the Court did not deem such retention of control sufficient to justify a disregard of the sale. If the original transaction is complete and was not made for the purpose of tax avoidance it cannot be ignored. This is the rule—it was followed in the *Bancitaly Corp.* case but it was not followed in this case, and the Tax Court was wrong in not following it.

It is apparent from a study of the cases relating to the deductibility of losses sustained from sales of property, many of which have been analyzed above, that the test of deductibility depends upon the intention of parties to the sale as to whether the sale was to be a real bona fide sale. If the sole purpose of the transaction or series of transactions from which the loss alleged to have been sustained is to create a tax loss and avoid tax, the sale trans-

action or other transactions by which this is accomplished are considered to be merely *pretended sales* or transactions and therefore unrealistic or a sham.

If the tax avoidance scheme is absent, a transaction must necessarily be given its effect according to its form because whatever the purpose might be, the intent must necessarily have been that the transaction in form should be effected to reach the intended objective. Where the tax avoidance scheme is absent, the Courts will recognize intent and purpose as separate and distinct factors and in such instances the purpose will not be applied to vitiate the intent with respect to the transactions employed to reach the desired purpose. There is no case where a sale was made for a purpose other than to accomplish a tax avoidance in which it was held that the sale was to be disregarded, even though there might have been a subsequent transaction no matter how close in point of time to the original sale transaction which was necessary to complete the desired purpose.

In this case the purpose of tax avoidance was absent. The sale by the Bank to Capital Company was made for the sole and exclusive purpose of settling a controversy with the Comptroller of the Currency in a manner which the Bank considered important to avoid establishing any precedent which might later be detrimental to it. The settlement of the controversy in the manner described was the purpose of the transaction; the intent of the Bank and Capital Company was that the sale should be a closed and completed transaction and that at least for a period of time the sale should be so effective as to divest the

Bank of all title and control of the property and to vest that complete title and control in Capital Company as the owner of the property; the intent had to comprehend such results would be accomplished by the sales transaction because it was only by such a transaction having such consequences that the Bank could accomplish its purpose, and be able to support its position that it did not make a mere paper transaction or write down of assets, but actually suffered a loss through a sale of property; the purpose of the arrangement with respect to the possible repurchase of the property was to have an understanding with Capital Company that the Bank could repurchase the property when and if it desired to do so, but the intent behind this repurchase understanding was that it should have no effect upon the original sales transaction and that it should have no legal or binding effect as an encumbrance on Capital Company's ownership of the property because again the ultimate purpose of avoiding precedent which might be detrimental to the Bank in the future required that there be no transaction which might alter the legal effect of the original sale.

As argued under the previous subheading of this argument, a disregard of the sale to Capital Company places a construction on the transaction as though it were a sale by the Bank to Merchants, which is in direct contravention of the purposes and intentions of the Bank. A sale by the Bank to Merchants was considered by the Bank but was rejected because it would not have accomplished what the Bank was trying to accomplish. (R. 91.) The Court cannot "im-

pose" upon a taxpayer a transaction which it did not execute, so the Tax Court has gone too far in disregarding the sale to Capital Company and imposing upon the Bank a transaction which it had deliberately refused to make.

The statute (Section 112) requires nothing more than that the cost shall exceed the selling price in order that there be a determination of loss from the sale of property. The question of intent, of realism, arises from principles established by case authority in applying the statute which principles were devised to prevent the deduction of losses from unrealistic transactions made solely for the purpose of defeating the revenue. It is respectfully submitted that in this case there was a sale from the Bank to Capital Company and the selling price was less than the cost of the property sold so that a loss was sustained by the Bank when a sale was made. The element of tax avoidance is not present so there is nothing to bring into play the principles devised to prevent tax avoidance.

In this case there was a later sale by Capital Company to Merchants, but before that sale was made, Capital Company was the owner of the property, in complete control of title and income, which income was included by it in its income tax returns and subjected to tax; Capital Company was bound by nothing more substantial than a moral commitment made with the Bank to resell the property to the Bank at its request, which commitment was made with the deliberate understanding that it was to be merely a moral commitment and not a legal and binding obligation,

and so again the agreement for resale was not such a reserved power to the seller which could vitiate the original sales transaction and the legal consequences thereof, nor did it have the effect of vitiating Capital Company's ownership of the property from the time it purchased until the time it sold. The very intent of the parties was that the repurchase arrangement should not have any effect upon the original sales transaction. There is no basis whatever under this analysis of the principles pronounced in the cases on the subject, for disregarding the sale from the Bank to Capital Company and the consequences of such sale under the tax statutes. The loss was sustained. There is no restriction against its allowance as a deduction under the statute so it should be allowed.

It is the appellant's view that the sale of its property to Capital Company must be recognized and that the loss sustained upon that sale must be allowed. Under this view of its case, the later sale by Capital Company to Merchants is of no consequence in a determination of the issue involved herein. However, since The Tax Court took the position that the sale should be construed as a sale from the Bank to Merchants, it is necessary to submit some discussion of the case on that premise since the appellant believes that even on that premise The Tax Court erred in refusing to allow a deduction for the loss sustained in the sale.

(g) The Sale of the Properties by Capital Company to Merchants Was a Complete and Bona Fide Transaction.

There is nothing complicated about the transaction whereby Capital Company sold the eight properties to Merchants in 1943. Paragraphs 5, 6 and 7 of the stipulation show that Capital Company sold the properties to Merchants for cash at a price equal to Capital Company's cost plus cost of acquisition, and show also that all legal formalities with respect to the transaction were complied with. (R. 34-38.)

The Tax Court had no complaint about the validity of this sale but in view of its position that Capital Company was "merely a conduit through which petitioner could transfer formal title to Merchants" (R. 137) and that "the sale must be viewed as being made between petitioner as vendor and Merchants as vendee" (R. 139) it ignored the transaction between Capital Company and Merchants.

III. THE BANK'S DOMINATION AND CONTROL OVER MERCHANTS AS ITS WHOLLY OWNED SUBSIDIARY CANNOT BE CONSTRUED AS DOMINATION AND CONTROL OVER THE ASSETS OF MERCHANTS, AND CANNOT JUSTIFY A DISREGARD OF THE CORPORATE ENTITY OF MERCHANTS.

After concluding that the transaction had to be viewed as a sale between petitioner and Merchants (R. 139) The Tax Court stated, "the question thus becomes what effect does the closeness of the relationship between petitioner and Merchants have upon the deductibility of the loss in question". (R. 139.) The Tax Court concluded the loss was not deductible

and it stated "The basis for the decision is the complete domination and control which petitioner continued to exercise over the properties transferred through its complete domination and control of its wholly owned subsidiary". (R. 141.) Expressing it in another way The Tax Court concluded "The facts clearly show that there is no substance to the sale of the branch banks by petitioner to its wholly owned subsidiary. Petitioner had complete domination and control over Merchants and the properties in the hands of Merchants were as much subject to petitioner's control as they were while legal title was in petitioner's own name. * * * In effect and substance Merchants was no more than the *alter ego* of petitioner, and 'no loss could occur upon a sale by a taxpayer to such an entity.' " (R. 142-143.)

There is no justification in fact or in law for the conclusion above quoted. Here are the facts as stipulated—

Merchants had a net worth during 1943 as shown by the Balance Sheet appearing as Schedule L, page 4, of its income tax return (Ex. 22-V, R. 111) of about \$19,000,000.00. It had rental income in 1943 of approximately \$982,000.00 and expenses and depreciation aggregating the same amount, so that it had no net income for tax purposes. (Ex. 22-V, R. 110.) It will never have a net taxable income because under a formal lease agreement executed between the Bank and Merchants *under date of August 1, 1936,* the rental payable by the Bank to Merchants is fixed at "an amount equal to the total of all expenses and charges of the lessor, which are allowable to the

Lessor, Merchants National Realty Corporation, as deductions from gross income for Federal income tax purposes, less an amount equal to the total income of the lessor derived from all souces other than the rental to be paid hereunder". (Lease Ex. 7-G, paragraph First, R. 73).[2] The lease also provided that "it is agreed that from time to time the Lessor and the Lessee may add to the parcels of property covered by this lease, by agreeing that the same shall become a part of the property covered hereby" * * * etc. (Lease Ex. 7-G, Paragraph Tenth, R. 77.)

The stipulation, paragraph 7, states "The properties deeded by Capital Company to Merchants as stated above, were thereafter held by Merchants under this lease". (R. 38.) This same paragraph of the stipulation shows that many of the officers and directors of the Bank were also officers and directors of Merchants, that Merchants had no salaried employees, and that whatever work was necessary to the operation of the Company's business was performed by employees of the Bank. (R. 38.) Nevertheless, Merchants, as a separate corporate entity, did own property, it did conduct a business of leasing its property to the Bank (Stip. paragraph 7, R. 38) and its business did require its expenditure of over $500,000 in 1943 for expenses of its business (Ex. 22-V, R. 110), and it maintained a bank account ranging from $2,184,000 at the beginning of 1943 to $290,000 at the end of the year. (Ex. 22-V, R. 111.) The purchase of

[2]But it could have book net income or net loss due to limitations under tax laws as for example the provision which prevents allowance of net capital losses—Sec. 117 (d) (1).

property by Merchants in 1943 and the leasing of the property to the Bank by adding it to property covered by the 1936 lease, is no different than what Merchants has been doing ever since the execution of the lease on August 1, 1936, and the lease itself contemplates just such transactions by making specific provisions therefor. (Ex. 7-G, paragraph Tenth, R. 77.)

Any parent of a wholly owned subsidiary has domination and control over the subsidiary by virtue of its stock ownership, but it has never been held that such domination and control alone justified a disregard for tax purposes of the corporate entity of the subsidiary or a disregard of transactions between the parent and the subsidiary. On the basis of this premise the only question is whether the lease arrangement between the parent and the subsidiary is so unrealistic as to justify a disregard of the corporate entity of the subsidiary? A complete answer to the question would seem to be a practical one, i.e., the lease had been in existence for years prior to 1943 and was not changed in 1943; and the sales transaction here under discussion was entered into in 1943 as a legal and realistic transaction consummated for a purpose entirely unrelated to tax considerations; so there is nothing so different in 1943 to justify the conclusion that in 1943 the corporate entity of Merchants should be disregarded and the Bank should be deemed to be the real owner of the property owned by Merchants. This practical answer should be the best and a sufficient answer, but there are even further answers. There are a number of cases, some of which

are briefed in the appendix hereto, where the business arrangements between the parent and the subsidiary were more unusual than the lease arrangement in this case and yet the Courts refused to disregard the corporate entities on that ground. There is no general rule that transactions between a parent and its subsidiary are to be ignored. The rule is that separate corporate identities must not be ignored. *National Carbide Corp. vs. Commissioner* (1949) 336 U.S. 422 (cited in appendix hereto).

There is very little difference in substance in the business arrangements between the Bank and Merchants and the business arrangements between the parent and the subsidiaries under consideration in the *National Carbide Corp.* case, supra. Since the Supreme Court ruled that those arrangements were not sufficient to justify a disregard of the corporate entity of the subsidiaries in the *National Carbide* case, the similar arrangements between the Bank and Merchants could not be sufficient to justify a disregard of the separate identity of Merchants.

The Bank urges that the transaction considered in this proceeding was a sale of property by it to Capital Company and the loss sustained as computed under the income tax statutes should be allowed as a deduction. If this Court should be of the same view as the Tax Court that the sale was a sale by the Bank to Merchants, then, as hereinabove just argued, the loss is still allowable as a deduction to the Bank because the corporate identity of Merchants cannot be ignored and there is no circumstance which is legally suffi-

cient to support a refusal to apply the income tax statutes under which this loss must be recognized as a deductible loss.

IV. CONCLUSION.

It is respectfully urged that the sale of the properties by the Bank to Capital Company was a real and bona fide sale, made for a purpose other than to obtain a tax deduction; that the arrangement for the repurchase of the property by the Bank and the sale of the property to Merchants is immaterial to the recognition of the sale to Capital Company; and that the loss resulting from that sale is an allowable deduction for income tax purposes. It is urged further that even if the transaction is viewed as a sale of property by the Bank to Merchants, the sale was a closed and completed transaction and the loss resulting therefrom must be recognized as a deductible loss for tax purposes. It is respectfully urged that the decision of the Tax Court denying this loss as a deduction should be reversed.

Dated, San Francisco, California,
June 1, 1951.

George H. Koster,
Attorney for Appellant.

Bayley Kohlmeier,
Of Counsel.

Appendix.

Appendix

In *Electric Auto-Lite Co.,* T. C. Memo Docket 111986, Aug. 4, 1943, the Court allowed a loss on the sale of stock of one subsidiary to another wholly owned subsidiary and remarked that it did not believe that *Higgins vs. Smith,* supra, should be regarded as a direction to disallow a loss resulting from a bona fide business transaction, the tax consequences of which were incidental to its purpose, and where neither subsidiary was organized or used as a tax-saving device. (See also *Laughton vs. Commissioner* CCA-9 supra, already discussed.)

The Tax Court cites cases, which have already been discussed, to support its position, and again it must be emphasized that all of these cases which support a disregard of corporate entity or a disregard of transactions are predicated on the factual premise that the intercorporate relationship or the questioned transactions were entered into for the sole purpose of avoiding tax liability.

Reference has already been made to the case of *Bancitaly Corporation,* 34 B.T.A. 494 in which intercorporate relationships were not recognized as a basis for disregarding an intercorporate transaction upon which some $10,000,000 of "unrealized" profit was subjected to tax—of course, there was no tax avoidance purpose in the intercorporate transactions. Likewise, in the case of *Helvering vs. Johnson,* supra, 104 F (2d) 140, a deduction for a loss was allowed on a sale by taxpayer to a corporation which he controlled

and 50% of whose stock he owned—again there was no evidence of tax avoidance as the sole purpose of the transaction. A like situation existed in the *Chisholm vs. Commissioner* case hereinbefore discussed, 79 F (2d) 14.

This Court in the case of *Commissioner vs. Eldridge* (1935) 79 F (2d) 629, allowed a loss on a sale of stock made by an individual to his wholly owned corporation where the facts showed that the sale was made on the advice of an accountant and the corporation was not organized for the purpose of engaging in transactions to reduce taxes and in this case the Court emphasized that the corporate entities could not be ignored.

In *Brost Motors, Inc.,* Docket No. 15505, T. C. Memo. Oct. 29, 1948, the taxpayer corporation transferred real property to another corporation which was controlled by the same stockholders, directors and officers who owned taxpayer corporation. The transfer was made for security reasons and not solely to reduce tax liability. The Tax Court allowed the loss resulting from the transfer of the property. The Commissioner contended that the loss was not a real loss because (1) the transaction was made solely for tax purposes and (2) it was between corporations controlled by the same interest. The Tax Court concluded that there was a business purpose for the transaction, that there was an unqualified sale and transfer of the property, and that the entity of the purchaser could not be ignored even if it was under common control with the seller.

The Tax Court reached a similar conclusion in the case of *Anderson-Clayton & Co.,* Docket No. 15255, T. C. Memo Aug. 18, 1948, in which case the determination made by the Commissioner in his deficiency notice was much the same as the determination made by the Commissioner in his deficiency notice issued in the instant case. One corporation sold certain properties to another corporation. A third corporation owned all of the stock of the selling company and 89.5 per cent of the stock of the purchaser, and in reliance upon this fact, the Commissioner argued that the loss to the selling corporation was not an allowable deduction because the transaction had no business purpose, merely transferred assets from one operating unit of the petitioner to another and was a sham. The Court found that there was a business purpose for the transaction and that "there is no sound reason for disallowing the loss which Memphis actually sustained in selling the assets to West Texas".

The principal criterion in these cases involving transactions between affiliated corporations seems to be whether the transaction was *effected solely* for tax purposes. (*Crown Cork International Corp.* 4 TC 19, aff'd. CCA-3-1945, 149 F (2d) 968, and the two T. C. Memo cases above discussed.)

In the case of *Commissioner vs. W. F. Trimble & Sons Co.* (CCA-3-1938) 98 F (2d) 853, one corporation sold stock to another corporation and the loss resulting from the sale was disallowed by the Government because the same stockholders owned

the stock of both companies. In allowing the loss the Court reaffirmed the general rule that a corporation and its stockholders are deemed separate entities and the corporate entity will not be disregarded except where "too close a relationship between two or more corporations offends a statute or circumvents public policy, or when necessary to prevent fraud, or where one company is nothing but an agent of another". The Court said that even though a tax reduction resulted from the loss sustained in the transaction between the companies, such a result in itself does not come within the offenses justifying a disregard of the corporate entity.

The case of *Moline Properties, Inc. vs. Commissioner,* 319 U.S. 436, hereinbefore discussed, is probably the leading case on the proposition that corporate entities cannot be ignored for tax purposes unless the corporation is a sham or unreal and is used in such a way that its form is a bald and mischievous fiction, intended only to accomplish tax avoidance.

In *Frank & Leder Co.* (1928) 13 B.T.A. 1 (revd on other grounds 44 F (2d) 147) the Board of Tax Appeals refused to disregard a sale where options were given for repurchase and for limitation of loss, the Board being of the opinion that since the original sale was occasioned by business considerations alone, the option contracts and repurchase could not affect the bona fides of the sale.

In the case of *U. S. vs. Joliet and Chicago R. Co.* (1942) 315 U.S. 44, revg. 118 F (2d) 174, the Supreme Court held that a corporation is taxable upon

income constructively received by it when rentals due to it as lessor are paid directly to its stockholders. To the same effect, *Commissioner vs. Western Union Telegraph Co.* (CCA-2-1944) 141 F (2d) 774.)

We could discuss a great many more cases to show refusal of the Courts to disregard corporate entities or refusal to treat stockholders and their corporations as single entities where no tax avoidance schemes were involved, even in cases involving peculiar arrangements between the stockholders and their corporations. (For example, *U.S. vs. Joliet & Chicago R. Co.* supra 315 U.S. 44; *Commissioner vs. Western Union Tel. Co., supra,* 141 F (2d) 774; *Mississippi River & Terre Bonne Railway* (1939) 39 B.T.A. 995 allowing a subsidiary a loss on sale of property which had been leased to a parent under a lease quite similar to the Bank-Merchants lease; *Porter Royalty Pool, Inc. vs. Commissioner,* (CCA-6-1948) 165 F (2d) 933; *Railway Express Agency* 8 T C 991 rev'd on other grounds; *National Investors Corp. vs. Hoey,* (CCA-2-1944) 144 F (2d) 466, (cited in *National Carbide Corp.* 336 U. S. 412, discussion of which follows, which gives an interesting discussion as a prelude to the conclusion that a Corporate form must be unreal or a sham or its businesses confined to tax evasion, before the Treasury Department may disregard it), but we think that the rule that a corporate entity may be disregarded because of the dominion and control over it by its stockholders has been abrogated completely by the Supreme Court in its decision in the case of *National Carbide Corp. vs. Commissioner* (1949) 336 U.S. 422.

In the *National Carbide Corp.* supra case the taxpayers were three wholly owned subsidiaries of Air Reduction Corp. (Airco) and they claimed that they were mere agents of their parent so their income should be treated as income of the parent. Airco operated the businesses of the individual companies and they paid to Airco all their profits in excess of 6% on their outstanding stock. Top officials of Airco held similar positions in the subsidiaries. The Tax Court held that the income of the subsidiaries in excess of 6% of their capital stock was income of Airco. 8 T.C. 594. The Court of Appeals, (2d) Circuit reversed and the Supreme Court granted certiorari "because of this conflict of opinion and the disagreement between Courts as to the continuing vitality of *Southern Pacific Co. vs. Lowe* 1918, 247 U.S. 330". In referring to the decision of the Court of Appeals, the Supreme Court said:

> "*It held under our decisions, when a corporation carries on business activity the fact that the owner retains direction of its affairs down to the minutest detail, provides all of its assets and takes all of its profits can make no difference tax-wise. The Court concluded that 'Even though Southern Pacific Co. vs. Lowe, supra, set up a different test, we regard it as pro tanto no longer controlling.'*
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> "The result reached by the Court of Appeals is clearly required by our later decisions."

The Court pointed out that a subsidiary company might be an agent of its parent but a strict showing of such relationship would have to be made before

such relationship could be established for tax purposes. Mere dominion and control of the subsidiary either actual or through stock ownership is not sufficient to establish a relationship which the Supreme Court would recognize as an agency relationship for tax purposes.